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This Week in Derivatives

November 22, 2024

From the Derivatives Practice Group: The SEC announced that Gary Genseler will depart the agency on January 20, 2025 and the CFTC advanced a recommendation to expand the use of non-cash collateral through the use of distributed ledger technology this week.

New Developments

- **SEC Chair Gensler to Depart Agency on January 20.** On November 21, the Securities and Exchange Commission (the "SEC") announced that its 33rd Chair, Gary Gensler, will step down from the Commission effective at 12:00 pm on January 20, 2025. [NEW]

- **CFTC's Global Markets Advisory Committee Advances Recommendation on Tokenized Non-Cash Collateral.** On November 21, the CFTC's Global Markets Advisory Committee (the "GMAC"), sponsored by Commissioner Caroline D. Pham, advanced a recommendation to expand the use of non-cash collateral through the use of distributed ledger technology. The GMAC's Digital Asset Markets Subcommittee also presented on the progress of its Utility Tokens workstream. The recommendation by the GMAC's Digital Asset Markets Subcommittee was approved without objection, marking the 14th GMAC recommendation advanced to the CFTC in the last 12 months, the most of any advisory committee ever in the same timeframe. The CFTC said that the recommendation provides a legal and regulatory framework for how market participants can apply their existing policies, procedures, practices, and processes to support use of DLT for non-cash collateral in a manner consistent with margin requirements. [NEW]

- **CFTC Staff Issues an Advisory Related to Clearing of Options on Spot Commodity Exchange Traded Funds.** On November 15, the CFTC's Division of Clearing and Risk (the "DCR") issued a staff advisory relating to the clearing of options on spot commodity Exchange Traded Funds ("ETFs"). These options are on shares of the ETFs registered with the SEC as securities and the shares are listed and traded on a SEC-registered national securities exchange. These ETF options are cleared and settled by the Options Clearing Corporation ("OCC") as the sole issuer of all equity options. The advisory states, in light of relevant precedents in the courts, it is substantially likely these spot commodity ETF shares would be held to be securities. Therefore, DCR indicated that its position is that the listing of these shares on SEC-registered national securities exchanges does not implicate the CFTC's jurisdiction, and as such, the clearing of these options by OCC would be undertaken in its capacity as a registered clearing agency subject to SEC oversight. Accordingly, DCR said its position is that the CFTC does not have any more role regarding the clearing of these options on the part of OCC than with regard to OCC's clearing of any security. [NEW]

- **CFTC Publishes Customer Alert Regarding CFTC v. Traders Domain FX Ltd.** On November 14, the CFTC published an alert to customers who believe they may be victims of alleged fraud by Traders Domain FX Ltd. Customers are urged to complete this voluntary confidential customer survey, which will provide CFTC with pertinent information on this case.

- **CFTC Publishes Final Rule Adopting Amendments to Regulations Governing Registered Entities.** On November 7, the CFTC adopted amendments to its regulations under the Commodity Exchange Act that govern how registered entities submit self-certifications, and requests for approval, of their rules, rule amendments, and new products for trading and clearing, as well as the CFTC's review and processing of such submissions. According to the CFTC, the amendments are intended to clarify, simplify and enhance the utility of those regulations for registered entities, market participants and the CFTC. The effective date for this final rule is December 9, 2024.

- **CFTC Market Risk Advisory Committee to Hold Public Meeting on December 10.** On November 5, the CFTC's Market Risk Advisory Committee ("MRAC") announced that, on December 10, 2024, from 9:30 a.m. to 12:30 p.m. (Eastern Standard Time), it will hold a public, in-person meeting at the CFTC's Washington, DC headquarters, with options for virtual attendance. The MRAC indicated that it plans to discuss current topics and developments in the areas of central counterparty ("CCP") risk and governance, market structure, climate-related risk, and innovative and emerging technologies affecting the derivatives and related financial markets, including discussions led by the CCP Risk & Governance and Market Structure subcommittees with recommendations related to CCP cyber resilience and critical third-party service providers and the cash futures basis trade, respectively.

New Developments Outside the U.S.

- **IOSCO Publishes Consultation Report on Pre-Hedging.** On November 21, IOSCO published a Consultation Report inviting feedback on its recommendations relating to pre-hedging practices. The Consultation Report offers a definition of pre-hedging and proposes a set of recommendations intended to guide regulators in determining acceptable pre-hedging practices and managing the associated conduct risks effectively. [NEW]

- **The ESAs Publish Joint Guidelines on the System for the Exchange of Information Relevant to Fit and Proper Assessments.** On November 20, the European Supervisory Authorities (the "ESAs") announced the development of an ESAs F&P Information System with the purpose of enhancing information exchange between supervisory authorities within the European Union ("EU") and across different parts of the financial sector. The Joint Guidelines aim to clarify its use and how data can be exchanged. The Joint Guidelines are intended to ensure consistent and effective supervisory practices within the European System of Financial Supervision ("ESFS") and facilitate information exchange between supervisors. They apply to competent authorities within the ESFS and focus on two main areas: use of the F&P Information System and information exchange and cooperation between the competent authorities when conducting fitness and propriety assessments. [NEW]

- **Active Account Requirement - ESMA is Seeking First Input Under EMIR 3.** On November 20, the European Securities and Markets Authority ("ESMA") published a Consultation Paper on the conditions of the Active Account Requirement ("AAR") following the review of the European Market Infrastructure Regulation ("EMIR 3"). The amending Regulation introduces a new requirement for EU counterparties active in certain derivatives to hold an operational and representative active account at a CCP authorized to offer services and activities in the EU. ESMA is seeking stakeholder input on several key aspects of the AAR, including: the three operational conditions to ensure that the clearing account is effectively active and functional, including stress-testing; the representativeness obligation for the most active counterparties; and reporting requirements to assess their compliance with the AAR. ESMA indicated that it will consider the feedback received to this consultation by January 27, 2025 and aims to submit the final draft regulatory technical standards to the European Commission within six months following the entry into force of EMIR 3. ESMA will organize a public hearing on January 20, 2025. [NEW]

- **ESMA Proposes to Move to T+1 by October 2027.** On November 18, ESMA published its Final Report on the assessment of shortening the settlement cycle in the EU. The report highlights that increased efficiency and resilience of post-trade processes that should be prompted by a move to T+1 would facilitate achieving the objective of further promoting settlement efficiency in the EU, contributing to market integration and to the Savings and Investment Union objectives. ESMA recommended that the migration to T+1 occurs simultaneously across all relevant instruments and that it is achieved in Q4 2027.

Specifically, ESMA recommended October 11, 2027 as the optimal date for the transition and suggested following a coordinated approach with other jurisdictions in Europe. [NEW]

- **The ESAs Announce Timeline to Collect Information for the Designation of Critical ICT Third-Party Service Providers under the Digital Operational Resilience Act.** On November 15, the ESAs published a Decision on the information that competent authorities must report to them for the designation of critical Information and Communication Technology ("ICT") third-party service providers under the Digital Operational Resilience Act ("DORA"). In particular, the Decision requires competent authorities to report by April 30, 2025 the registers of information on contractual arrangements of the financial entities with ICT third-party service providers.

- **IOSCO Publishes Final Report on Promoting Financial Integrity and Orderly Functioning of Voluntary Carbon Markets.** On November 14, IOSCO released its Final Report on promoting the financial integrity and orderly functioning of the Voluntary Carbon Markets (VCMs). The report outlines a comprehensive set of 21 Good Practices aimed at ensuring financial integrity in VCMs, which, according to IOSCO, could be applicable across all carbon credit markets. In addition, IOSCO and the World Bank published a policy note outlining high-level elements intended to promote financial integrity in carbon markets generally, using the occasion to announce a new partnership in 2025. [NEW]

- **ESMA Collects Data on Costs Linked to Investments in AIFs and UCITS.** On November 14, ESMA announced it is launching a data collection exercise together with the national competent authorities ("NCAs"), on costs linked to investments in Alternative Investment Funds ("AIFs") and Undertakings for Collective Investment in Transferable Securities ("UCITS"). ESMA with the NCAs has designed a two-stage data collection involving both manufacturers and distributors of investment funds. Information requested from manufacturers will provide an indication on the different costs charged for the management of the investment funds. Information requested from distributors (i.e., investment firms, independent financial advisors, neo-brokers) will inform on the fees paid directly by investors to distributors. A report based on this data will be submitted to the European Parliament, the Council and the European Commission in October 2025.

New Industry-Led Developments

- **Ark 51 Adopts CDM for CSA Data Extraction.** On November 5, ISDA announced that Ark 51, an artificial intelligence ("AI") and data analytics service developed by legal services provider DRS, has used the Common Domain Model ("CDM") to convert information from ISDA's regulatory initial margin (IM) and variation margin ("VM") credit support annexes ("CSAs") into digital form. Ark 51 is a contract and risk management system that uses AI to extract key data from legal agreements, including IM and VM CSAs. The CDM transforms that data into a machine-readable format that can be quickly and efficiently exported to other systems, cutting the resources associated with manual processing.

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